DEPARTMENT OF PUBLIC SERVICE REGULATION
BEFORE THE PUBLIC SERVICE COMMISSION
STATE OF MONTANA

IN THE MATTER of the Amendment of	)
ARM 38.5.1902 Pertaining to Qualifying	)
Facilities	)

COMMENTS OF THE NATURAL RESOURCES DEFENSE COUNCIL

The Natural Resources Defense Council (NRDC) appreciates the opportunity to comment on the Public Service Commission's (PSC or Commission) proposed rule related to qualifying facilities (QFs).

NRDC understands the Commission's belief that competitive solicitations provide a greater level of assurance that long-term contracts with QF projects are least-cost, reflecting a utility's avoided costs, and enable more rational utility procurement in the context of the utility's existing portfolio of resources. There is a lot of merit in this view.

Still, there are several troubling aspects of the proposed rule that make it impossible for NRDC to support its adoption at the present time.

As an initial matter NRDC notes that changing the size of a QF eligible for the long-term standard rate from 3 MW to 10 MW and now to 2 MW (this proposal) in about a 4 year time span doesn't produce the kind of certainty and predictability sought to be achieved by regulation. A factor in determining whether to modify an existing regulation is the need or importance for its modification balanced against the disruption and uncertainty to the regulated community resulting from the change.

In this regard it's instructive to note what the Commission said in 2007 about its decision that 10 MW was the appropriate size for a facility to be able to receive the standard long-term rate. Most notably the Commission stated that because it had "no evidence that the standard offer rates exceed the utility's avoided costs" moving to 10 MW did not "contain substantial costs or risks for ratepayers." Montana Administrative Register, Issue 24, at 2140, 2142.

Similarly, NRDC submits that there is scant, if any, evidence, that today's Commission published avoided costs rates do not track reasonably well with "actual" avoided costs. Indeed, the Commission staff memo on the proposed rule does not say otherwise. Instead the staff memo states only that the rate "may not adequately track actual avoidable costs...." (Emphasis added.) The staff memo's concern in this regard is based, entirely it appears, on the contentious nature of avoided cost proceedings and the challenge in establishing avoided cost rates. No one can dispute that characterization of prior QF dockets or that determining avoided costs is difficult. But, NRDC believes that the staff memo overlooks the excellent job the Commission does navigating these dockets. NRDC believes that the nature of an avoided cost docket does not, by itself, call into question the accuracy of the Commission's published rate.[1]

It's a somewhat curious situation the Commission finds itself in. Shortly after issuing Order 7108e in D2010.7.77, which set QF rates, the Commission considers a proposed rule change that, in essence, says those rates may not be accurate. Again, that gives the work that the Commission put into D2010.7.77 too little credit.

[1] Moreover, the proposed rule change is designed to guard against only one outcome: the possibility that avoided cost rates may be set too high, producing uneconomic outcomes. Yet there is an equal possibility that the rates may be set too low, which would lead to disadvantageous results for consumers and society.

Another argument that has been made in support of reducing the size of a QF that can avail itself of the long-term standard rate and, instead, must enter into competitive solicitations is that QF's between 2 MW and 10 MW are sophisticated enough to participate in such solicitations. NRDC agrees that QFs that are at or around 10 MW have the capacity to engage in competitive resource solicitations. NRDC does not know, and suspects the Commission does not know, where the break point is between 2 MW and 10 MW (or even if there is a break) in terms of the capacity of a QF developer to meaningfully engage in a competitive solicitation.

But the issue in this rulemaking regarding the competitive solicitation alternative is not really whether a QF has the ability to engage, it's whether the solicitation will be fair and will produce the economically rational procurement outcome that the Commission seeks to achieve by its proposed rule.

There is reasonable basis for concern that the backstop role envisioned to be played by competitive solicitations will not perform up to expectations. First, there have been allegations that a procurement process recently employed by NorthWestern Energy (NWE) was not fair. Whether this allegation is true or false is not the point. Rather such an allegation indicates the need for a strengthened set of Commission rules relating to competitive solicitations. Second, the adversarial nature of the relationship that exists between IOUs, and in particular NWE, and QFs and the interest in NWE owning generation should not give the Commission confidence that the playing field will be entirely level.[2]

More broadly, the Commission should not be under any illusions about competitive solicitations. NRDC does not dispute that in a perfect world, with all else equal, a

[2] Commission staff, in the past, has been quite critical of NWE, stating that "NWE's lack of progress in acquiring QF resources, despite evidence of substantial QF interest, raises concerns regarding discrimination and anticompetitive behavior." Staff memo at 7, Docket D2008.12.146. This language was not included in Order 6973d.

competitive solicitation will produce a more accurate read of the "market" than a PSC established rate. But, of course, the world changes, is not perfect, and things aren't equal. Make no mistake a competitive solicitation can produce a disconnect. As a result of that disconnect, a long-term contract can be entered into and approved by the Commission that is not economically justified. In fact, a staff data request to NWE (PSC-20d) in the last avoided cost docket, D2010.7.77, was exploring this possibility when it asked NWE whether in light of changed circumstances rate-basing Colstrip 4 was appropriate.

Perhaps of most significance is the combined effect of a competitive resource solicitation requirement and the proposed change away from the requirement to conduct all-source solicitations. Allowing a utility to remove a class of resources from consideration will certainly allow for greater control of resource procurement. But, in Montana it could mean, where almost all QF activity is associated with wind generation and depending on the type of competitive solicitations, that virtually all QFs larger than 2 MW are shut out from acquiring the long-term standard rate. The effect of this, since a QF may need the certainty of a long-term rate to render a project viable as a business proposition, might be to preclude these projects altogether.

Such an outcome may be satisfactory to NWE. During the hearing on the proposed rule, NWE announced that, with its recent acquisitions (and not knowing what the Commission will decide about Spion Kop) it would not be acquiring additional wind generation. Regardless of the merits of this position, resource procurement is supposed to be informed by the utility's Procurement Plan. NWE's 2009 Plan sent mixed messages about whether the utility would seek additional wind resources despite the fact that the Plan showed portfolio benefits from the acquisition of such resources. Now NWE is saying that the QF contracts it has recently entered into and Spion Kop are a fulfillment of the Plan. It's an open

question, however, whether NWE would have acquired these resources were it not for PURPA's requirements.

Finally, NRDC does not believe that the issue of regulating costs (i.e., integration costs) is particularly germane to the proposed rule change. With the removal of Option 3, QFs are required to either self-supply regulation services or accept the PSC rate for the cost of these services. To begin with, the additional need for regulation on NWE's system should not be significant for a single 10 MW QF. But, even if it is or even if the costs associated with additional regulation are significant (because, for example, the Dave Gates Station cannot provide sufficient regulation), these costs are identified and must be paid by the QF in addition to their published rate. Presumably, this is exactly what happens when the PSC sets the short term rate under the present regime. If there is a concern that the integration rate may change over time and the PSC wants to avoid the risk of locking it in for an extended number of years under a long-term rate and contract, the PSC could simply require that the integration rate be reopened and adjusted every few years.

In summary, NRDC is not convinced in the necessity of the proposed rule change. That is not to say that the PSC is not attempting to respond to legitimate concerns. It is a balancing act. On the one hand the Commission must evaluate the extent to which its proposed rule constrains QF development. Too far over that line the Commission cannot cross. In making this evaluation the Commission needs to weigh the justification for the proposed rule. So, 1)how important is it to avoid the uncertainty associated with a PSC determination of avoided costs and the associated possibility that in so doing the PSC may set those costs too high, and 2)is a competitive solicitation alternative reasonable? If the PSC asks itself the right questions, even if it comes to a different conclusion than is suggested by these comments, it will have done its job.

Assuming the PSC wishes to retain the basic outlines of its proposed rule, the PSC should consider changing the sentence in the rule that states what happens if a QF has a short term contract but fails to bid into the "first available competitive solicitation." Since, the proposed rule would allow competitive solicitations to be targeted to particular resources, a QF shouldn't be held to account for failing to enter into a competitive solicitation that it is not able to enter. The PSC should clarify this language.

Thank you for the opportunity to comment.

Charles Magraw

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